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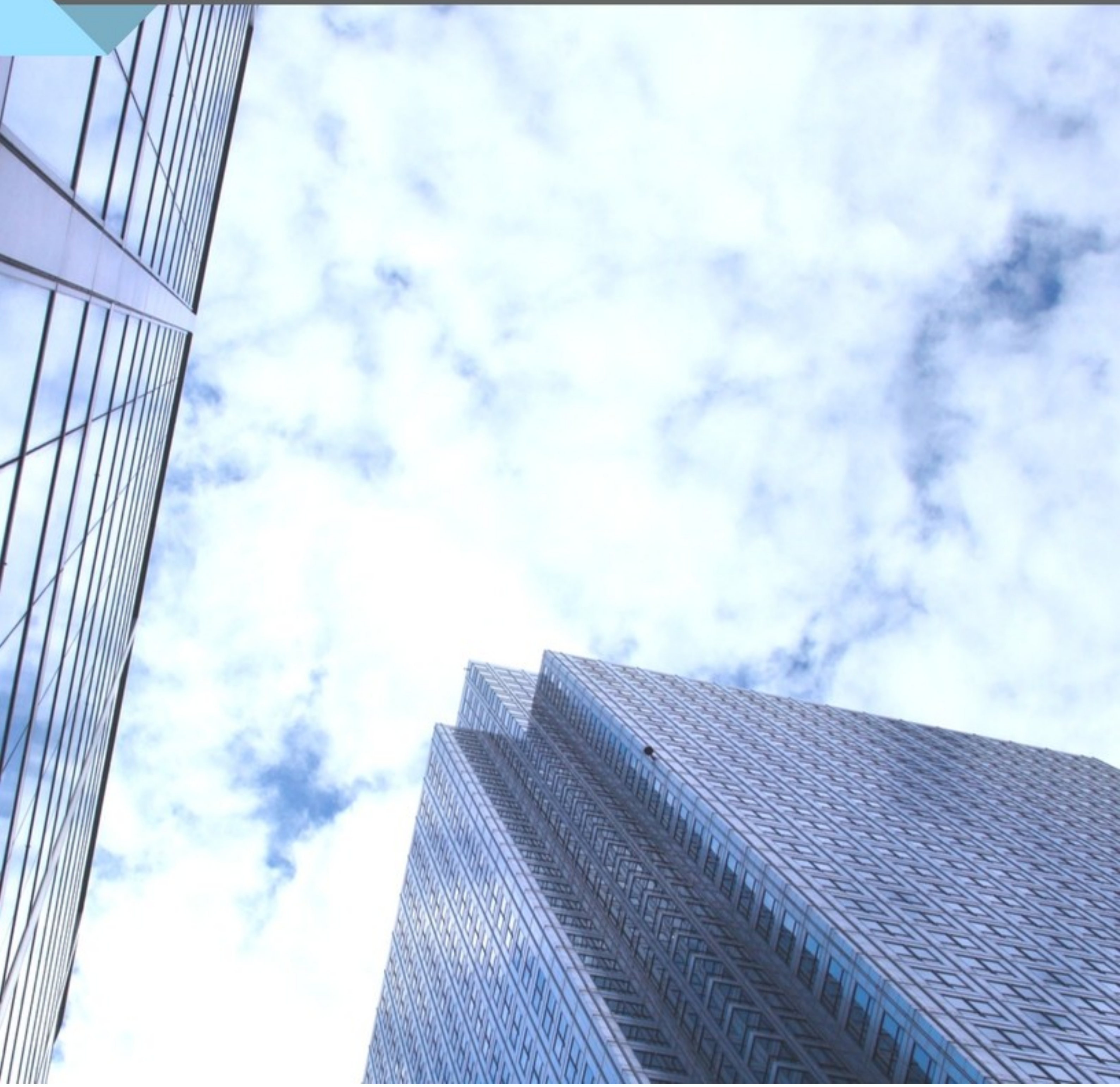
FDC MONTHLY ECONOMIC UPDATE



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☏:01-2715414, 6320213; Email: info@fdc-ng.com; Website: www.fdcng.com

In This Issue ...

The Economics of Wages

The concept of a minimum wage is universal and has its origins in the Poor laws of the 18th century Britain, the early days of the industrial revolution. Workers were of the view that capitalists were exploitative. They believed that minimum wage helps mitigate the imbalance of power between employers and low-wage workers. In the absence of a wage floor, employers could take advantage of workers' vulnerability and weaknesses. This could undermine the purchasing power of low income earners.

Therefore, it is not surprising that the minimum wage debate in Nigeria has generated a lot of passion. In pure macroeconomics terms, a higher minimum wage could trigger structural unemployment as more workers are being attracted to work while employers could be less willing to take on additional labor. More importantly is that GDP which is a measure of aggregate output is dependent on factor inputs (labor and capital). As labour demand declines, there is a downward movement along the production function leading to a lower real GDP. In addition, a decline in the quantity of labor, given the current level of technological advancement could result in low labour productivity, resulting in an inward shift in the production function and hence lower GDP. Hence, lower output coupled with a boost in liquidity would mount inflationary pressures.

In Nigeria, the minimum wage has been a subject of acrimonious debate for years with policy makers and labor in a virtual deadlock. The Nigerian Labour Congress (NLC) and the Federal government recently reached a tentative agreement on a figure of N30,000, averting another slowdown. N30,000 is 67% higher than the current wage of N18,000. The minimum wage was last reviewed in 2011, when a 140% increase was implemented from N7,500. At that time, N18,000 was worth $200 in the forex market. According to the law, the minimum wage should be reviewed at least once every 5 years. This implies that this review is almost two years overdue.

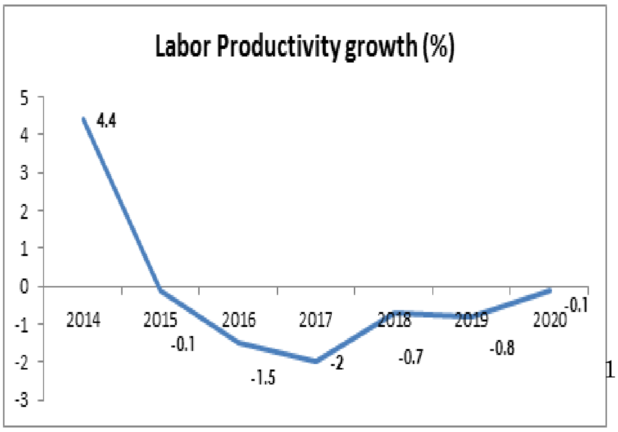
One of the major justifications for the wage review remains the deteriorating macroeconomic conditions i.e. lower purchasing power. This has resulted in a higher cost of living and a decline in the standard of living. The proposed minimum wage – at about $83 per month – is still suboptimal compared to what was paid in 2011, when the dollar equivalent of the minimum wage was $200. To restore a low wage earner back to the level it was in 2011, the optimal minimum wage would be approximately N72,000. To compensate for the value lost to inflation, the optimal wage should rise even further to N130,000. Nonetheless, the implementation of the new wage is expected to have both positive and negative impact on households as well as the aggregate economy.

Positive Impact

A higher minimum wage would boost employees' purchasing power, increase aggregate demand and ultimately stimulate economic growth. Consumption accounts for a significant proportion of the Nigerian National income model. Hence, a boost in consumption would significantly impact on the country's national income. In addition, an increase in consumption would induce investment spending, which would then have a multiplier effect on the overall economy.

Negative Impact

An increase in the minimum wage will boost liquidity and increase aggregate demand. However, given the structural rigidities as well as poor labour productivity in Nigeria, it is unlikely that output would increase to meet rising demand. This would result in a shift in equilibrium and the spike in money supply will likely be a destabilising factor for price stability. Furthermore, firms could reduce labour demand in response to higher labour costs and take drastic measures such as downsizing. This would increase the unemployment numbers.



[1]

In addition, given the current economic conditions in Nigeria, the fiscal sustainability of this new minimum wage regime is questionable due to limited progress made on increasing non-oil revenue, huge budget deficits and rising federal and states' debt. An increase in recurrent expenditure stemming from the wage increase could crowd-out the much needed capital expenditure. Some states are in a struggle to meet their current wage obligations. Thus, a higher minimum wage would compound this dilemma.

Conclusion

While it is expedient to implement the new minimum wage, it is more important to broaden the country's revenue base. There is a need to deepen non-oil revenue collection and increase the efficiency of tax collection.

There is also a need to boost aggregate output which is constrained by the inadequacy of existing infrastructure – especially power supply. An improvement in power supply will lead to a reduction in demand for alternative sources of energy such as diesel. This would reduce firm's operating costs, increase profit margins and improve the private sector's ability to pay the proposed minimum wage. In addition, higher profits imply more revenue to the government in form of higher tax receipts.

[1]EIU, FDC Think Tank

Is Oil Price at its Point of Inflection?

Brent oil prices are down 31.8% from a peak of $86.29 in October. Evidently, the Iranian sanctions had a redundant effect/impact on crude prices, as Brent prices have endured a 7-day losing streak since the effective date of the sanctions (November 4). Signs of waning demand and growing supply have weighed on the bullish outlook of this Black Gold. [2]

Shale production surge negative for Nigeria

The 20% increase in shale oil production to 11.6mbpd over the last 12 months has also dealt a major blow to the market optimism of most oil exporting economies such as Nigeria. The African giant being a highly commodity dependent economy is poised to be affected by these recent developments. Crude oil revenue accounts for 84% of its export revenue and over 60% of its fiscal inflows. Consequently, Nigeria remains at the peril of swings in the global oil market.

Are fiscal consolidation efforts under threat?

Despite Nigeria being more production than price sensitive, a bearish crude oil price will weigh on government's fiscal consolidation efforts, as well as the economy's external reserves accretion. The recent improvement in Nigeria's fiscal balance can be largely attributed to a combination of factors.

The current administration's near austerity approach to governance has seen both spending cuts and intensified revenue deepening. The Nigerian government increased its tax revenue by 42% to N2.52trn in H1'18 alone, representing 75% of the total target for the year. This was buoyed by higher than expected Brent oil price, which has averaged $73.07pb so far, 43.3% higher than the government's benchmark of $51pb in 2018 and 21.8% more than 2019 benchmark.[3] The government also announced a 4.3% decline in its 2019 annual budget of N8.76trn compared to N9.12trn in 2018. [4]

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[2]Bloomberg. (2018, November 13). *C01: COM (Brent Crude Future)*. Retrieved from Bloomberg.

[3]Organization of the Petroleum Exporting Countries (OPEC). (2018, November 13). *Monthly Oil Market Report. Vienna: OPEC.*

[4]*2019-2021 Medium Term Expenditure Framework (MTEF). (2018) Retrieved from Budget Office*

These strategic moves will narrow Nigeria's fiscal deficit going forward, improving Nigeria's debt servicing-to-revenue ratio – currently at over 60%. Either way, the Nigerian economy will maintain these safety nets in the short-term. However, growth might remain muted in the near-term owing to the current contractionary monetary policy approach.

Oil price rally, hit or miss?

The oil price rally in 2018 also saw Nigeria's external reserves climb up to $47.87bn in May, before retreating to $41.74 by mid-November. However, this remains robust (10.39 months import cover) despite massive capital flow pressures as Nigeria prepares for its 6th general elections since its return to civilian rule in 1999. This could see Nigeria's external reserves decline below the $40bn mark before the February 16 general elections. The concerted efforts by the Central Bank of Nigeria (CBN) to uphold investor confidence in the face of growing uncertainty will remain the most potent downside risk to external reserves accretion.

Outlook

At the global front, the declining trend in crude oil prices from weak demand forecast will necessitate a consensus for further supply cuts among the OPEC and some non-OPEC members. The trickledown impact of this move will negatively impact Nigeria. For instance, the current MTEF proposes an oil output of 2.3mbpd, 28% higher than Nigeria's OPEC quota (of 1.8mbpd). This is a key concern considering the fact that local refineries lack the productive capacity to absorb the 0.5mbpd excess over the current quota. A downward review will worsen external reserves accretion and threaten exchange rate stability.

Additionally, IMF's Regional Economic Outlook for the October 2018 alludes to the fact that the oil price rebound has been key to the boost in fiscal revenue of oil producing countries in Sub-Saharan Africa. However, Nigeria's hesitation to adjust domestic fuel prices in line with rising oil prices will be a major fiscal risk, increasing leakages in an ailing/ recovering economy.

Naira under Increased Pressure in the forex Market

Global oil prices (Brent) have averaged $73.07pb in 2018 and remained comfortably above the budget benchmark of $51 per barrel (pb), largely due to high demand and the output-cut led by the Organization of the Petroleum Exporting Countries (OPEC) and its allies. This has ultimately translated to stronger external buffers with gross external reserves peaking at $47.87bn in May. The robust reserves supported the CBN's interventionist strategy as the apex bank maintained its sterilized interventions, resulting in the naira has trading relatively stable so far in 2018. In the month of October, the currency traded flat at N362/$ at the parallel market. However, speculative pressures have intensified against the naira due to policy and political uncertainty in the build up to the general elections. As a result, the naira depreciated to N363/$ on November 8.

Uncertainty weighs on forex market

Typically, foreign investors are more risk averse towards countries in an electoral cycle. In addition, they are now also concerned about the high handedness or perceived targeting of MTN Nigeria by the administration. They fear that what is happening to MTN could also befall other multinationals operating in Nigeria. This has increased the unease and outward flows of hedge funds and portfolio investors, supporting the depletion of external reserves. The external reserves have declined consistently since the peak in May and are now currently below the psychological threshold of $42bn. The sustained decline can also be attributed to the effects of monetary policy normalization in the advanced economies, which has resulted in increased capital outflows. Thus, exchange rate pressures have intensified with naira put contracts selling as high as N365/$ at the IEFX window. It is worth stating that the IEFX window is a better reflection of market reality than the official rate and thus suggests that the naira is likely to depreciate further in the near term.

CBN sustains forex interventions

Meanwhile, the sustained downward trend in external reserves coupled with the decline in oil prices cast doubts about the CBN's ability to sustain its forex interventions. The CBN has intervened with a total of $547.16mn so far in November. This is 27.45% below a total of $754.15mn sold in the first two weeks of October and 63.76% below the total forex interventions in October.

Outlook

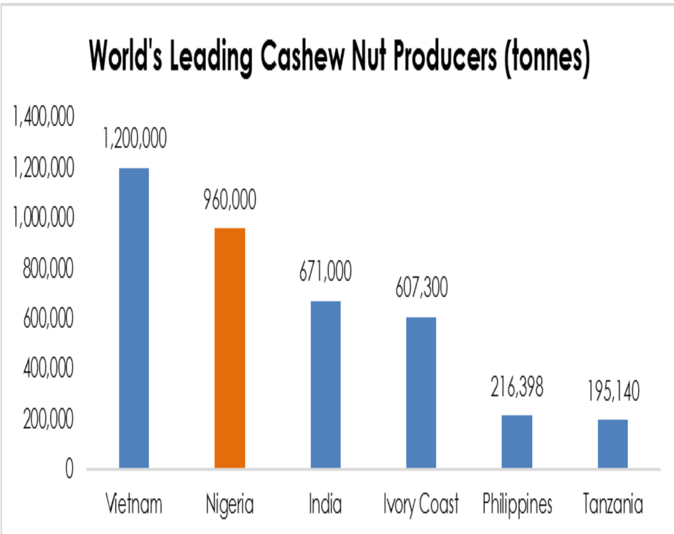
The CBN recently disclosed that it remains committed to maintaining exchange rate stability and is prepared to achieve this at the expense of external reserves. In light of this, we expect the CBN to continue its interventionist strategy. Nonetheless, the naira is likely to depreciate slightly in the in the near term as manufacturers and retailers continue to build inventories ahead of the festive season.

Cashew nuts, a potential source of increased revenue for Nigeria

Agriculture in Nigeria has significantly improved in the last few years. In the past, most farmers engaged in subsistence farming to meet the needs of their family while very little agricultural products was either sold domestically or exported. In recent times, growth in agricultural output has been on the rise as farmers are shifting to larger-scale farming investments and ultimately increasing agricultural outputs.

The Nigerian soil and climatic condition are suitable for the production of a wide variety of commodities, which have the potential to generate revenue and foreign exchange for the government. One such commodity is cashew nuts, in high demand due to the nutritional value and taste.

Nigeria is the largest producer of cashew nuts in Africa, and the second largest in the world, with about 960,000 tonnes in 2017(20% of global production). In Q2'18,cashew farming took centre stage in Nigeria, as the most exported non-oil commodity, contributing about 45% to agricultural exports and 0.86% of the total export value. With global demand increasing by 53% since 2010, cashew has the potential of being a major foreign exchange earner for Nigeria in years to come.[5]



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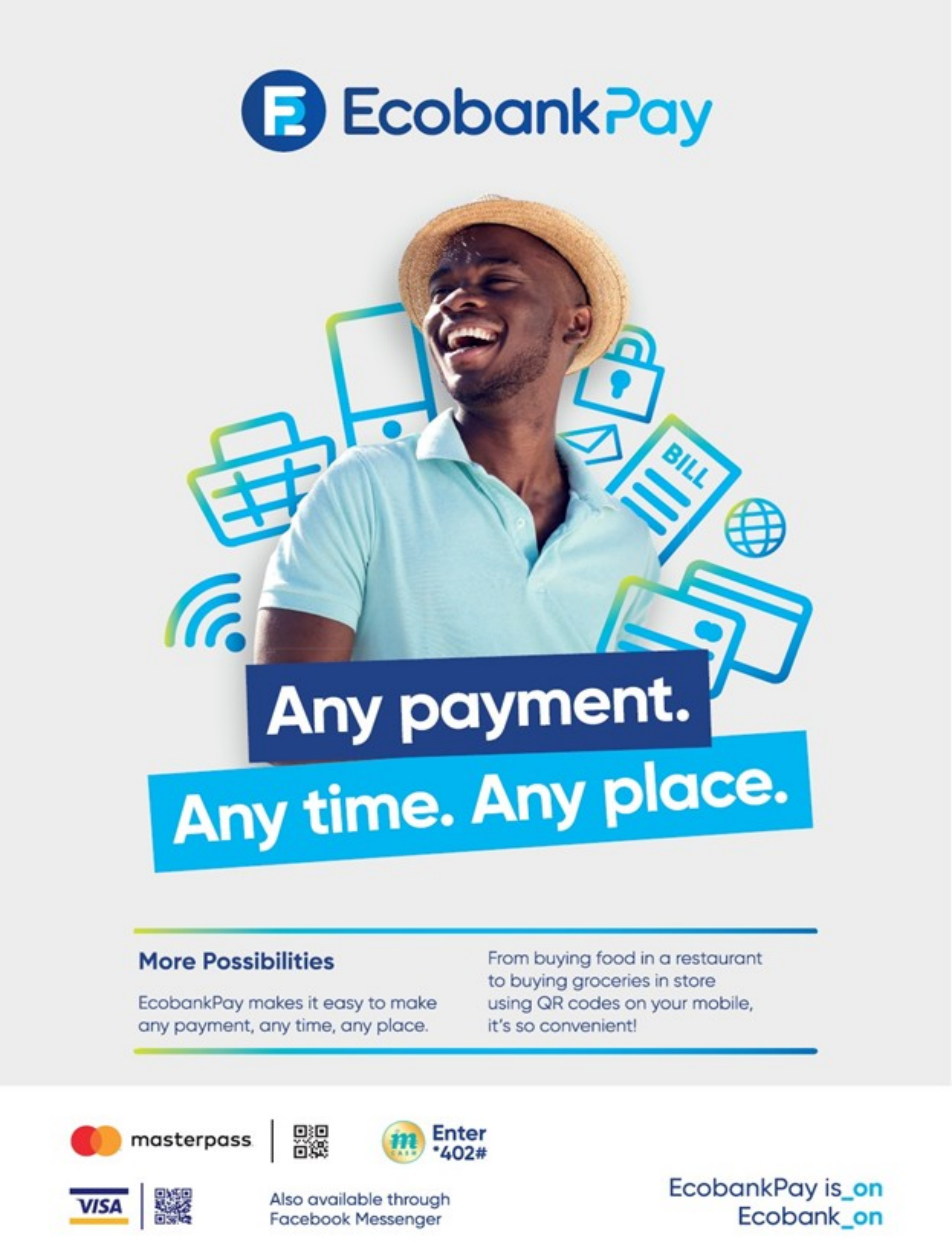
[5]Proshare intelligent investing. April 2018. https://www.proshareng.com/news/Commodities/Nigeria-is-World-Second-Largest-Producer-of-Cashew-Nuts/39348#

[6]World Atlas; FDC Think Tank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Although Nigeria relies greatly on the oil industry for its export revenue, the need to increase revenue inflow from the exportation of commodities such as cashew nuts is essential and an opportunity. To accelerate growth in the cashew industry, Nigeria needs to focus on improved funding for its cultivation, mechanized and modern farming techniques as well as advanced preservation and processing technology.

Challenges that can hinder production of cashew nuts

Nigeria's cashew nut production is not without its challenges. One of the major challenges that constrains cashew farming is inadequate funding for its cultivation. At the beginning of 2018, the National Cashew Association of Nigeria (NCAN) set a target of $480mn as foreign earnings from cashew exports in 2018, up 19.40% from $402mn in 2017.[7] However, only $121mn has been accomplished so far in H1, due to high interest rates from commercial banks to finance cashew production.

Vietnam, the largest producer of cashews, is also the largest processor, accounting for about half of all global cashew exports and the main supplier for the US market. In the harvest season of 2016/17, the global cashew production declined by about 30% - 40% (125,000 to 250,000 tonnes), following disruptions to supplies due to weather conditions, which reduced yields and quality of the crop in Vietnam.[8] Despite the global decline in supply from Vietnam, cashew exports from Nigeria remained low due to the lack of proper processing facilities. Vietnam and India are greatly dependent on Nigeria for raw cashew nuts. About 70% of Nigeria's production is exported to Vietnam for processing before being exported to other countries such as US.

Cashew production in Nigeria is mainly carried out by small-medium scale farmers who lack mechanized and modern farming techniques, have limited access to quality seedlings, fertilizer and equipment. These factors remain a major hindrance to sustainable growth in cashew production.

Solutions

It is important for Nigeria to reduce its dependence on oil and diversify into non-oil activities especially agriculture. The need for improved cashew production cannot be overemphasized. To ensure increased cashew production, NCAN needs to be encouraged. One of the mandates of the association is to ensure effective and sustainable management of Nigeria's cashew industry through improved post-harvest preservation, utilization and storage using profitable technological processes. Adequate funding for the association will aid quality research that can be deployed for the growth and development of the industry. There is also a need for stable and consistent federal government agricultural policies that will enable farmers to get loans at competitive rates. Such measures will help revive the industry and boost production.

[7] Oluwakeme Daude, Oct 8, 2018. "Cashew exporters seek N13b credit from banks." The Nation.http://thenationonlineng.net/cashew-exporters-seek-n13b-credit-from-banks/

[8] Fruit World Media-Admin, July 28, 2017. "Cashews: More Demand Than Supply", The Clipper. https://theclippermag.com/index.php/featured/cashews-demand-supply/

Farming in Nigeria is constrained by a lack of infrastructure. Commodities, such as cashews nuts, are exported in raw form and at low prices. Farmers are unable to make abundant incomes compared to countries like India and Vietnam that are leading cashew processors, as the ability to export globally acceptable cashew nut usually fetch higher prices. Nigeria needs to build new processing plants to improve the quality of the production of cashew nuts to meet international standards, which helps to achieve better pricing and export revenues.

The need to revive cashew production is essential as the over-dependence on oil continues to weigh heavily on depleting external reserves. To do so, Nigeria needs to invest in conducting research into new and improved cashew farming techniques, cashew technology and modern agronomy practices to improve crop yield and expand cashew production. The country also needs to develop processing plants which yield higher revenues than raw nuts when exported.

In conclusion, expansion of the cashew industry will help provide employment opportunities in the industrial sector, increase supply for domestic consumption as well as increase foreign revenue earned through agricultural exports. With a potential output of 2mn tonnes per annum,[9] cashew can be the next big thing for Nigeria if government policies allow for lower interest rates and processing infrastructure is created.

[9]FDC Think Tank

Global Perspective: *Culled from Financial Times*

Why China's business innovation can survive the trade war

The billionaire community in China is morphing into an altogether different beast. Previously it created wealth by following the west's business models and lifting them to the next level. Today it is developing its own business models, seizing opportunities at an unprecedented pace and moving rapidly into new business sectors.

This is unquestionably the economic story of our times. It is extraordinary to reflect that China only introduced private enterprise some 30 years ago. By 2006, the country boasted 16 billionaires. That figure rose to 373 last year, according to the UBS/PwC Billionaires Insight Report.

The drivers of this phenomenon are manifold, but they are best understood within the context of three broad themes.

Firstly, China has become the world's pre-eminent "mobile-first" nation, with 770m internet users accessing the web using their phones by the end of last year. This has created vast and growing addressable markets in e-commerce, micro credit and payments. At the same time, the government recognises China's potential and has rolled out policies to encourage technological advancements.

This combination of the Smartphone's swift adoption, a huge population and significant government support has created one of history's greatest moments for new enterprise.

As a result, it is perhaps no surprise that over the past two years, China has produced 50 companies that have gained unicorn status; just 12 behind the US. Most of these are based in Shenzhen, which is recognised as the capital of hardware and social networking enterprises. But Shenzhen is not China's only tech hub: Beijing leads the country's software development and Hangzhou is a centre for e-commerce.

Secondly, the new cohort of Chinese billionaires has been forged out of a fierce entrepreneurial spirit. While historically great wealth in China has been created through manufacturing and real estate, entrepreneurs are now seeking out riskier opportunities in fintech, biotechnology and AI.


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It should therefore come as no surprise that fortunes are easily lost as well as made in China: while 106 people became billionaires in the country last year, nearly half as many (51) dropped off the list. The stakes are high, and Chinese entrepreneurs are not afraid to play their cards.

Thirdly, a striking characteristic of Chinese billionaires — and one which also applies to the previous generations who built their wealth on manufacturing and real estate — is an underlying commitment to innovation.

Importantly, this commitment is not to product innovation per se but rather to innovation in operating models and services.

In China, entrepreneurs are quicker to seize business opportunities than their western peers, often undertaking less rigorous business planning in the desire to get to market quickly.

They are also younger — Chinese billionaires are 55 years old on average, compared with an average of 64 globally — and this is perhaps reflected in the energy with which they reinvent their companies continually.

Unlike many in the west, Chinese billionaires don't seek to establish defensible positions for their products; instead, they seek to build the scale that will make their businesses unassailable. They know that only domination will enable them to see off the threat of eventually becoming disrupted. This is why they transform their companies over and over again.

It used to be said that the Chinese excelled in copying products and business models developed in the west. No longer. In e-commerce and other areas of technology, they are disrupting processes and business operations at an unprecedented rate, shifting rapidly between business sectors.

This flexibility will serve Chinese billionaires well should trade tensions with the US escalate further. Under such a scenario, China's growth rate is likely to slow. Yet the structural transition of its economy towards urbanisation and a catch-up in productivity due to technology will continue to offer fertile ground for young and hungry entrepreneurs. China's billionaires are poised to set a new business agenda.

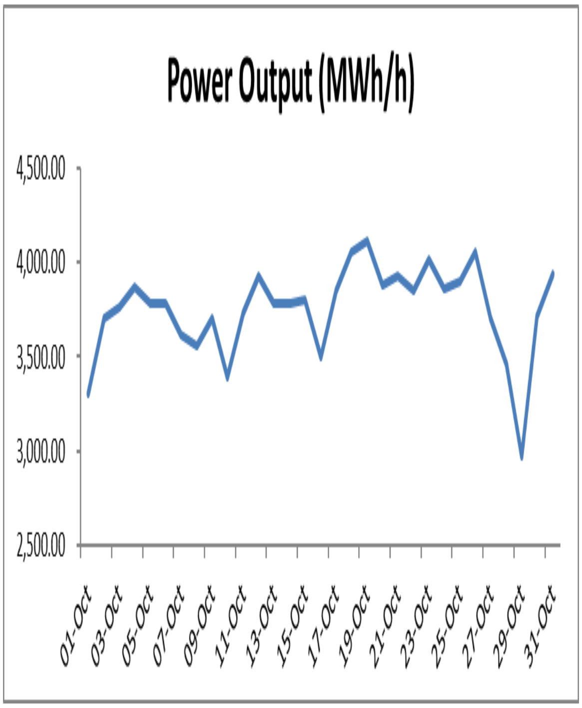
Josef Stadler is Head of Global Ultra High Net Worth, UBS

Macroeconomic Indicators

Power Sector

The average power output sent out from the national grid was 3,752.23MWh/h in October, 6.77% higher than September's average of 3,514.47MWh/h. Power output crossed the 4,000MWh/h threshold to a five-month high of 4,115MWh/h on October 19th, before retreating to a two-month low of 2,979MWh/h on October 29th. The month of October witnessed increased rainfall which filtered through to an improvement in hydro-generated power. Meanwhile, hydro-generated power accounts for only 30% of the country's total power output.

Gas limitations remained the prevailing challenge in the month, increasing the number of idle power plants to 15 on October 29th from seven at the beginning of the month. Revenue shortfall in the month was N52.45bn (N6.29trn annualized).



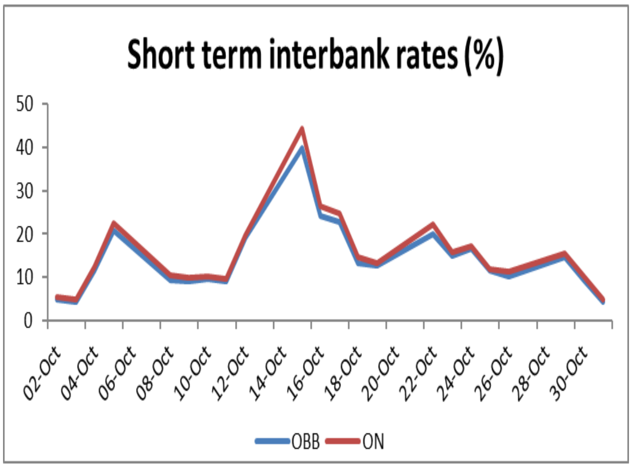
[10]

Outlook

In November, we expect the level of power output to be mainly dependent on gas availability as rainfall subsides. Meanwhile, the African Development Bank (AFDB) has approved $10mn to the Nigeria Infrastructure Debt Fund (NIDF) which is managed by Chapel Hill Denham. The essence of this is to finance the country's infrastructure investments needs, including the power and energy infrastructure sectors. This is expected to have a long-term positive impact on power output.

Money Market

The average opening position of banks was 52.2% lower at N202.12bn in October compared to N423.23bn in the previous period. The sharp decline in market liquidity led to a spike in the short-term interbank rates. Average NIBOR (OBB/ON) rates climbed to 14.81% from 7.69% in September. During the month, OBB & ON reached a high of 39.92% pa and 44.33% pa respectively on October 15th before retreating to a low of 4.33% pa and 4.92% pa on October 31st respectively following FAAC disbursements.



[11]

In October, more OMO bills were issued relative to OMO maturities. Total OMO bills sold were N1.62trn against an aggregate maturity of N1.28bn; the net outflow was N340bn. The total OMO sales were also higher by 69.13% than in the preceding month.

[10]FGN, FDC Think Tank
[11]FMDQ, FDC Think Tank

At the primary market, T/bill yields maintained an upward trend. However, the secondary market rates recorded a mixed movement. While the 91-day and 364-day increased, the 182-day declined. The NITTY rates declined by an average of 383bps during the review period.

NITTY Tenor	Rate on Oct 2nd (%)	Rate on Oct 30th (%)	Direction
30	13.5	11.80	↓
90	13.76	12.95	↓
180	14.59	13.27	↓

Primary Market

T/bills Tenor	Rate on October 3rd (% pa)	Rate on October 31st(%pa)	Direction
91	10.9	10.98	↑
182	12.10	13.49	↑
364	13.33	14.40	↑

Secondary Market

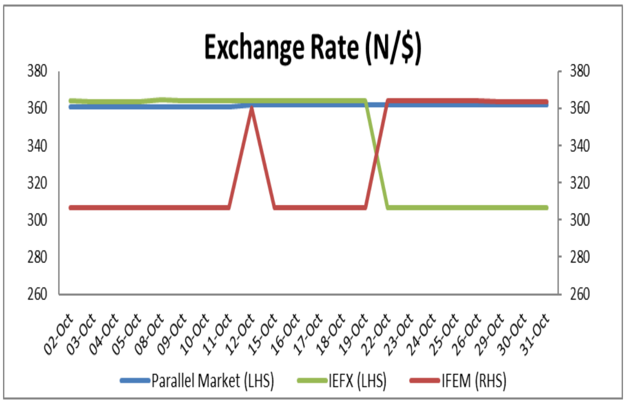
T/bills Tenor	Rate on October 3rd (% pa)	Rate on October 31st (%pa)	Direction
91	12.00	12.22	↑
182	12.83	12.78	↓
364	12.94	14.2	↑

Outlook

The movement of short-term interest rates would be dependent on the level of market liquidity. The key drivers of a boost in liquidity in the near term will be growing election spending, festive spending and the imminent minimum wage. In addition, the DMO has issued 10-year tenure promissory notes amounting to N771bn in favour of oil marketers and contractors being owed by state governments. Beneficiaries could either cash out at maturity or present to banks at a discounted rate. While the latter would accord the beneficiaries the ability to clear loan arrears, it would increase money supply and heighten inflationary pressures.

Forex Market

Exchange Rate



[12]

At the parallel market, the naira traded relatively stable at N361/$-N362/$. However, currency pressures are building at the Investors' and Exporters' Foreign Exchange (IEFX) window. Transactions are now being executed at an average rate of N364/$, compared to N362/$-N363/$ in previous months. This is due to increased forex demand by investors who are repatriating their funds. The CBN sold a total of $1.51bn in October, 45.19% higher than $1.04bn in September. Meanwhile, the total turnover at the IEFX window was 26.61% lower at $4.8bn.

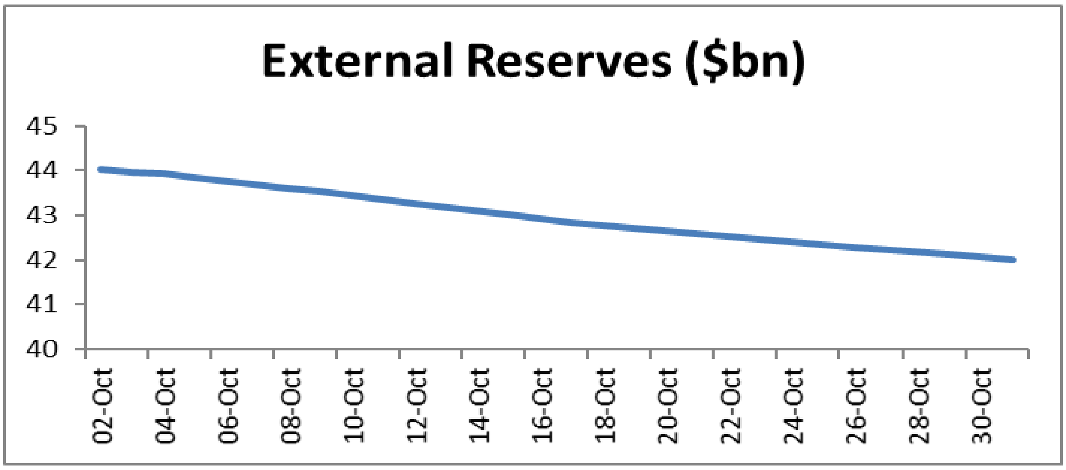
[12] FMDQ, CBN, FDC Think Tank

Outlook

We anticipate increased forex demand in the next couple of months as manufacturers commence inventory build-up for festive sales. This, in addition to increased election spending, could result in exchange rate depreciation. However, the CBN has iterated its preference for exchange rate stability over buoyant external reserves. Hence, we expect the currency to remain relatively stable in 2018.

External Reserves

External reserves depleted further in October at a faster pace, falling below the psychological resistance level of $42bn. The indicator fell by 4.62% ($2.04bn) to close the month at $41.995bn on October 31st from $44.03bn on October 2nd. Cumulatively, the reserves lost $2.31bn in the month. This was spurred by the Central Bank of Nigeria's (CBN) continuous intervention amid increased foreign capital outflows as a result of political uncertainty and monetary tightening in the advanced economies such as the US. The import cover declined to 10.46months from 11.03 months on September 28th.



[13]

Outlook

The sustained depletion of the external reserves is expected to be sustained in subsequent months, owing to forex demand pressures arising from election and festive spending. In addition, we anticipate one more hike in the US Federal Reserves' (the Fed) interest rate in 2018. This would further intensify capital outflows, heightening pressures on the exchange rate. However, higher oil proceeds could slowdown the pace of depletion.

[13] CBN, FDC Think Tank

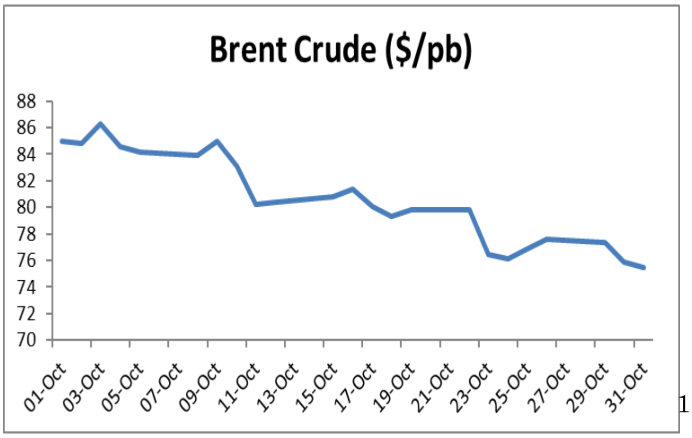
COMMODITIES MARKET - EXPORTS

Oil Prices

The average price of oil was $80.63pb in October, 1.86% higher than the average of $79.16pb in September. However, oil prices declined by 11.19% to close the month at $75.47pb from $84.98pb on October 1st. This bearish trend in oil prices was buoyed by higher oil output from Russia and Saudi-Arabia, OPEC's largest exporter. Projections of a slowdown in global economic growth as well as rising US crude inventories supported the declining trend.

Outlook

In spite of the commencement of sanctions on Iran, OPEC's third largest oil exporter, Brent crude prices fell to $71.96pb on November 6th. This is because markets had already factored in the sanctions. Oil prices are expected to remain volatile in the next couple of weeks but trading above $70pb.



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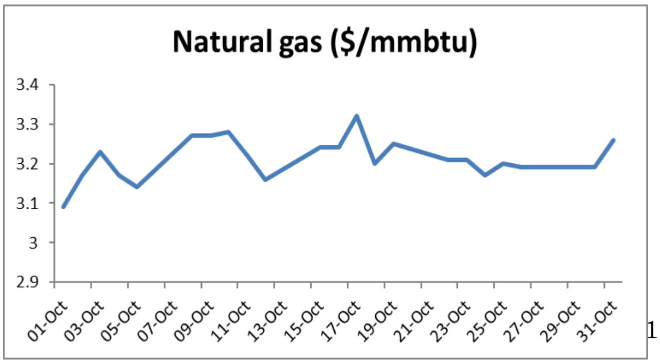
Natural Gas

The average price of natural gas was $3.21/mmbtu in October. This is 10.69% higher than September's average of $2.90/mmbtu. Natural gas prices rose by 5.50% to $3.26/mmbtu on October 31st from $3.09/mmbtu on October 1st. The increase was spurred by strong Asian demand and forecast of colder weather in the US in November.

Outlook

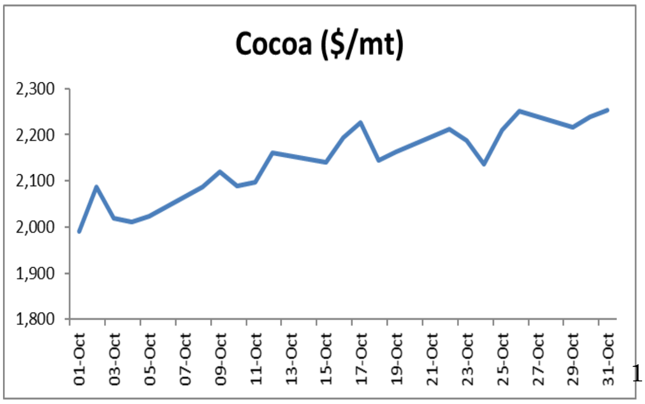
The forecast of colder weather across the US as the winter period approaches will increase the use of heaters and ultimately boost the demand for natural gas. This is expected to drive up natural gas prices in the short-term.



[15]

Cocoa

The average price of cocoa in the month of October was 9.93% lower at $2,141/mt compared to the previous month. Cocoa prices rose by 13.22% to $2,253/mt on October 31st from $1,990/mt on October 1st. The rise in the cocoa price was partly due to the International Cocoa Organisation's report of a surge in the global demand of cocoa owing to increased production of chocolates.



[16]

Outlook

Higher global production of chocolate, especially from European and Asian countries, is expected to raise the demand for cocoa. Cocoa is a major input in chocolate production thus, an increase in chocolate demand would likely push up prices.

[14]Bloomberg, FDC Think Tank
[15]Bloomberg, FDC Think Tank
[16]Bloomberg, FDC Think Tank

COMMODITIES MARKET - IMPORTS

COMMODITY UPDATE

Wheat

The price of wheat was down 1.76% to close the review period at $5.00/bushel from $5.10/bushel on October 1st. The average price fell by 0.97% to $5.11/bushel from $5.16/bushel in the previous month. This was due to the robust wheat harvest in the US and trade tensions between the US and China.

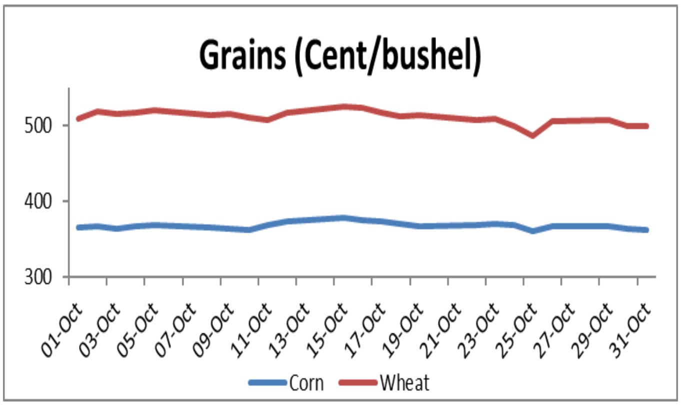
The U.S. Department of Agriculture (USDA) maintained Russia's 2018/19 wheat export forecast at 35 million tonnes in spite of the rumours that output would decline.

Corn

Corn prices dropped 0.66% to close the reviewed month at $3.63/bushel from $3.66/bushel at the beginning of the month. The average price of corn was $3.68/bushel compared to $3.66/bushel in the September. The decline in the price of corn was mainly driven by robust US output.

Grains- Outlook

We expect a bearish trend in grain prices in November. This would be driven by strong harvest from the US, forecast of robust output from Russia and reduced grain demand outlook resulting from trade tensions between the US and China.



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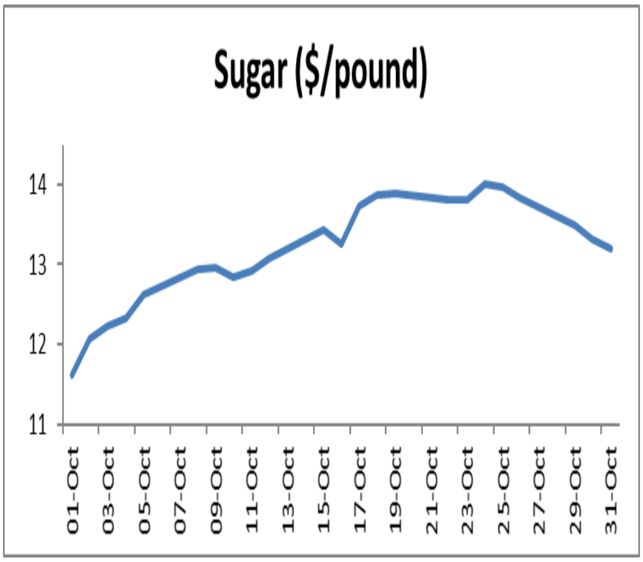
Sugar

Sugar prices rose by 13.61% to $0.1319/pound on October 31st from $0.1161/pound on October 1st. The average sugar price in October was 0.96% higher at $0.1156/pound compared to $0.1145/pound recorded in the previous month. The rise in sugar prices was partly driven by reports of unfavourable weather conditions in Brazil and the Indian Sugar Mills Association's (ISMA) downward revision of India's sugar output in 2018/19.

Outlook

A lower sugar output forecast for India would signal a downtick in the supply of sugar in the global market. Lower rainfall forecasted in November for Brazil would also be unfavourable for Brazilian sugar producers. Therefore, lower supply from India (2nd largest producer of sugar) combined with forecasted unfavourable weather conditions in Brazil (largest producer of sugar) is expected to weigh on the global supply of sugar and push up prices in the near term.



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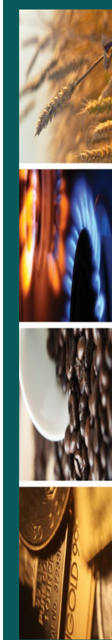
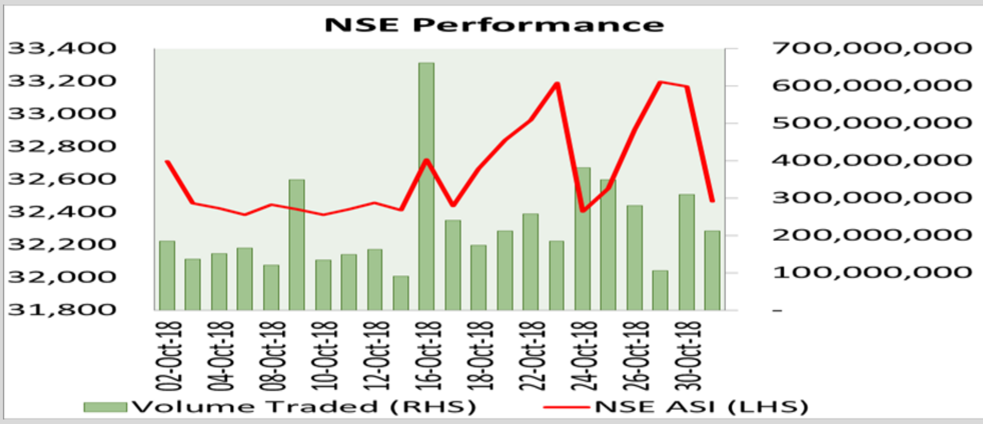


[17] Bloomberg, FDC Think Tank
[18] Bloomberg, FDC Think Tank

Stock Market Update

The Nigerian stock market sustained its losses into October despite the release of some impressive corporate results for 9M'18. NSE ASI dipped 0.92% to close at 32,466.27 points. Similar to the ASI, market capitalization declined to N11.85trn.

The NSE ended the month of October at a price to earnings (P/E) ratio of 9.17x. This is a 1.8% decline over the close of the previous period's P/E of 9.34x. Market breadth remained negative at 0.50x, as 33 stocks increased, 70 stocks remained flat, while 66 declined; compared to September, which came in at 0.44x.



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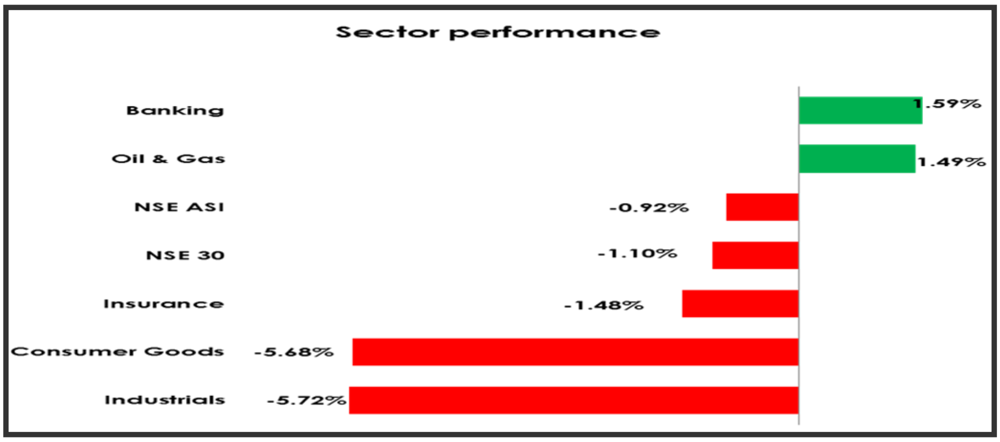
Trading activities on the floor of the NSE reflected the weak investor sentiment. Average volume traded declined by 19.46% to 207mn units, whilst average value of trades moved in the opposite direction, up 25.88% to N3.94bn.



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All indices except banking and oil & gas closed the month of October in negative territory. The industrial sub-sector index was the biggest loser. The index lost 5.72% in October owing to lackluster 9M'18 corporate results from key bellwether companies such as Dangote Cement and Flour Mills Nigeria. The share price of industry heavy-weight, LaFarge Africa declined sharply by 21.57%.

The banking sub-sector index gained the most among the NSE sub-sector indices. The sector's performance was driven by sharp rises in the price of shares such as Fidelity (20%), Diamond (19.49%) and Zenith (9.3%)

[19]NSE, FDC Think Tank
[20]NSE, FDC Think Tank

Banking sector stocks led the gainers' chart. Penny stocks were also among the top gainers, largely attributed to bargain hunting on undervalued stocks. Fidelity Bank (20%) led the advancers, followed by Diamond Bank (19.49%), Newrest Asl Nigeria Plc. (17.86%), Consolidated Hallmark Insurance Plc. (13.79%) and Cornerstone Insurance Co Plc (10%).

Company	Sep 28'18	Oct 31'18	% Change	Absolute Change
FIDELITY BANK PLC	1.70	2.04	20.00	0.34
DIAMOND BANK PLC	1.18	1.41	19.49	0.23
NEWREST ASL NIGERIA PLC	5.60	6.60	17.86	1
CONSOLIDATED HALLMARK INSURANCE PLC	0.29	0.33	13.79	0.04
CORNERSTONE INSURANCE COMPANY PLC.	0.20	0.22	10.00	0.02

Industrial and Insurance stocks dominated the laggards with Cutix Plc. (-50.49%), McNichols Plc. (-43.06%) and Niger Insurance Plc. (-29.73). Honeywell Flour Mill Plc. (-26.21%) and John Holt Plc. (-24.53%) also featured among the decliners.

Company	Sep 28'18	Oct 31'18	% Change	Absolute Change
CUTIX PLC.	4.10	2.03	-50.49	-2.07
MCNICHOLS PLC	0.72	0.41	-43.06	-0.31
NIGER INSURANCE CO. PLC.	0.37	0.26	-29.73	-0.11
HONEYWELL FLOUR MILL PLC	1.45	1.07	-26.21	-0.38
JOHN HOLT PLC.	0.53	0.40	-24.53	-0.13

Outlook

Foreign and domestic investors are expected to remain tentative in light of the proximity to the 2019 elections which are expected to be keenly contested. The stock market is therefore expected to remain firmly in correction territory in the month of November.

Corporate Focus: Okomu Oil Palm Company PLC

Analyst Recommendation: HOLD

Market Capitalization: N76.12bn

Recommendation Period: 365 days

Current Price: N75.75

Industry: Agriculture

Target Price: N75.43

Analyst's note

Okomu Oil Palm Company Plc (Okomu) recorded a relatively flat top-line in the first nine months of 2018 (9M'18). The company recorded a marginal increase of 0.59% in turnover to N16.68bn from N16.59bn in 9M'17. However, the 7.11% decline in the company's production cost helped to shore up its gross profit by 1.95% to 14.38bn in 9M'18.

Sliding prices of rubber and oil palm weighed on export revenue growth

The breakdown of Okomu's revenue by location showed a decline in export revenue, while local sales (within Nigeria) remained robust. Revenue generated from sale to the local market increased marginally by 1.9% to N14.64bn. However, the strengthening dollar and the weaker than expected demand in commodities such as rubber and oil palm exerted pressure on Okomu's export earnings. This is evident from the 7.6% decline in revenue from exports to N2.04bn. These exogenous factors are likely to continue to weigh on the company's foreign earnings especially from rubber exports. This will reverse some of the gains recorded in 2017, where prices of rubber rallied by 24% and palm oil prices by 44%. This resulted in a 41.05% surge in Okomu's turnover in 2017 to N20.26bn.

Lower debt service and tax provision boosts bottom-line

The company recorded a 13.3% spike in profit after tax to N7.24bn in 9M'18. This improvement, over the corresponding period in 2017, can be attributed to the 54.97% decline in net finance charges to N0.02bn and a 46.81% decline in taxes to N1.48bn.

Policy uncertainty could weigh on growth

The agricultural sector has been one of the main beneficiaries of the government's intervention programs. These have been in the form of access to credit and some level of protection by regulatory agencies. For instance, the Central Bank of Nigeria's (CBN) ban of 41 items (including palm oil products) from accessing foreign exchange on the official market, proved to be a major support to agricultural firms like Okomu. Imported palm oil products became relatively expensive and thus unattractive. Nonetheless, the possibility of a policy somersault cannot be totally ruled out, considering the numerous policy turnarounds by the regulatory agencies. As a result, we place a HOLD rating on the company's stock.

Industry and company overview

In the last three decades, Nigeria's palm oil output has largely lagged its potentials. This was mainly due to the lack of improved seedlings, outdated and inefficient machinery, poor milling infrastructures, and inaccessibility of land.

However, the Nigerian government's intervention in the space has enabled the oil palm industry to gain traction. The government identified agriculture as one of the 'low hanging fruits' poised to kick start growth through export revenue diversification and self-sufficiency. Oil palm has been one of the commodities key to the revitalization of the agricultural sector, partly due to the series of by-products obtained from the milling and processing value chain and the export potential of a mature oil palm industry.

Furthermore, the oil palm business is a scale enterprise; players in the sector cater to the industrial needs of a variety of customers such as consumer goods, cosmetics and pharmaceutical companies. Oil palm is also a major retail commodity used to garnish meals and a good source of essential vitamins. Key Nigerian companies that use oil palm as inputs include Nestle, Cadbury, Indomie (owned by Dufil) and Unilever.

The two major players in the market are Presco and Okomu. Both companies are listed on the Nigerian Stock Exchange (NSE). Other players include PZ Wilmar and DUFIL Prima Foods. However, Presco and Okomu remain the most recognized brands in raw oil palm production in Nigeria. Players in the sector cater to the industrial needs of a range of customers (consumer goods, cosmetics and pharmaceutical companies). Okomu is Nigeria's second largest producer of palm oil.

Okomu was incorporated on December 3, 1979 as a private limited liability company. It was subsequently converted into a public limited liability company on September 19, 1997. Ownership is largely concentrated with foreign investors, through the Socfinal Group of Luxembourg. The group owns 62.6% of Okomu's shares with Nigerian investors accounting for the rest (37.4%).

Okomu operates through two segments: palm oil products and rubber products. (The rubber business segment comprises about 20% of Okomu's total revenue.) The company is primarily focused on the production and development of oil palm plantation, oil milling, palm kernel oil, palm kernel cake, Banga red palm oil and rubber cup lumps.

Income Statement for Okomu Plc (FY Dec 2017)				
N'000	**2014**	**2015**	**2016**	**2017**
Revenue	8,655,718	9,738,015	14,364,736	20,261,918
Other work performed by the entity capitalized	656,858	1,448,193	2,293,062	3,752,431
Changes in inventories of the finshed goods and WIP	100,328	(41,170)	145,543	721,028
Raw materials and consumables used	(2,071,942)	(1,803,659)	(3,305,572)	(4,841,153)
Other external charges	(2,244,939)	(2,885,254)	(2,658,798)	(3,701,166)
Employee expenses	(899,865)	(728,909)	(790,476)	(832,799)
Depreciation on property, plant & equipment	(734,977)	(916,786)	(960,333)	(1,022,701)
Depreciation on bearer biological assets	(223,500)	(228,288)	(234,786)	(253,560)
Other expenses	(1,477,914)	(1,490,374)	(2,016,548)	(3,109,342)
Other income	192,070	186,413	114,734	153,530
Operating profit	1,951,837	3,278,181	6,951,562	11,128,186
Finance income	85,701	43,111	291,273	490,894
Gain on disposal of assets	8,534	6,534	4,206	5,444
Finance cost	(141,576)	(429,181)	(1,340,588)	(484,382)
Profit before tax	1,904,496	2,898,645	5,906,453	11,140,142
Income tax expense	(344,541)	(239,038)	(996,180)	(1,992,292)
Deferred tax charge	(230,000)	-	-	
Profit for the year	**1,329,955**	**2,659,607**	**4,910,273**	**9,147,850**

Balance Sheet for Okomu Plc (FY Dec 2017)				
N'000	**2014**	**2015**	**2016**	**2017**
Property, plant & equipment	10,255,455	9,848,681	9,217,423	11,216,535
Bearer biological assets	5,111,060	7,395,989	9,399,803	12,898,674
Non-current assets	15,366,515	17,244,670	18,617,226	24,115,209
Inventories	1,415,552	1,490,595	1,719,080	2,687,196
Trade receivables	105,304	62,856	121,086	465,222
Intercompany receivables			467,379	497,822
Other receiveables	626,875	296,592	384,643	512,911
Cash and bank balances	358,082	905,527	3,198,251	3,093,792
Current assets	2,505,813	2,755,570	5,890,439	7,256,943
Total assets	**17,872,328**	**20,000,240**	**24,507,665**	**31,372,152**
Share capital	476,956	476,955	476,955	476,955
Share premium	1,867,095	1,867,096	1,867,096	1,867,096
Revenue reserves	7,260,471	9,801,309	14,667,990	22,162,839
Other reserves				
Equity attributable to equity holders	9,604,522	12,145,360	17,012,041	24,506,890
Non controlling interests	-	-	-	-
Total equity	9,604,522	12,145,360	17,012,041	24,506,890
Deferred tax liabilities	1,704,811	1,733,273	1,755,473	1,660,273
Provisions				
Post-employment benefits obligation	496,256	352,650	315,965	671,133
Borrowings	1,477,305	3,386,168	2,416,252	765,458
Non-current liabilities	3,678,372	5,472,091	4,487,690	3,096,864
Trade payables	772,216	888,636	641,148	487,695
Other payables	97,585	67,477	114,929	28,349
Provisions and accruals	359,329	483,085	429,810	439,679
Borrowings	2,285,896	340,417	372,351	486,047
Tax payable	1,003,014	530,201	1,386,231	2,263,163
Dividend payable	63,465	63,465	63,465	63,465
Intercompany payables	7,928	9,508	-	-
Current liabilities	4,589,433	2,382,789	3,007,934	3,768,398
Total liabilities	8,267,805	7,854,880	7,495,624	6,865,262
Total equity and liabilities	**17,872,327**	**20,000,240**	**24,507,665**	**31,372,152**

Management

The ability of Okomu's management to sustain returns and drive growth in a period of weak economic growth can be attributed to its diversified business segments (oil palm and rubber).

To further drive growth and improve earnings, management has formally commissioned its Extension Two Estate at Ovia North East Local Government Area of Edo state. This enables the company to establish a second oil palm mill which will increase Okomu's production capacity and financial returns.

Okomu is led by a highly talented and experienced team that drives the company towards sustainable growth. Mr G Oyebode is the Chairman of Okomu and has developed significant experience in project finance, corporate law, energy and natural resources, telecommunications and aviation law. He has served as a director of Nestle, Socfinaf SA, MTN Nigeria Ltd and Access Bank Plc. He has an LLB Honors from the University of Ife, Nigeria and an LLM Honors from the University of Pennsylvania, Philadelphia.

Mr G D Hefer is the Managing Director of Okomu Oil Palm Plc. He has served as an Executive Director since2007.He has an MSc and PhD in Agriculture. Mr. Hefer has held director positions at Tongaat Cotton Limited and Noordelike Sentrale Katoen. He has also held the position of Lecturer/Research Fellow at the University of Natal. Under his visionary leadership, Okomu has expanded its plantation size and oil mill capacity to grow its revenue and production capacity.

Chairman

Mr. G. oyebode

Managing Director

Mr. G. D Hefer

The Bull and the Bear Says:

* Leading player in the Nigerian oil palm market
* Robust demand for crude palm oil and its derivative products
* Favorable government policies towards the agricultural sector
* Multiple entry points and appeal to the market – Okomu oil plays in both the retail and wholesale segment of the Nigerian oil palm market
* Okomu's rubber business provides diversification benefits
* Experienced and talented management
* Land expansion initiatives to broaden revenue base

* Intense competition from leading player such as Presco, PZ Wilmar, as well as international players like Olam
* Declining commodity prices
* Change in government policies could affect the competitiveness of companies in the agricultural sector, particularly the palm oil sector
* Persistent macroeconomic headwinds could dampen consumer demand for palm oil products

Risk and Outlook

The major risks that could prevent Okomu from achieving its goals of increasing production capacity, boosting earnings, and managing costs include currency risks, interest rate risks and possible changes in government policy.

Okomu is exposed to currency risk on sales, purchases and borrowings of raw materials denominated primarily in US dollars and euros, while it makes local payments and collects receipts in naira. The company mitigates these risks by holding foreign currency bank accounts which act as a natural hedge for such transactions. Another risk is an increase in interest rates, which arises from trade finance for financing its transactions. The company mitigates this risk through negotiations with banks. This is evident from the 47% decline in the company's net-finance costs in its 9M'18 financial performance.

In relation to government policy, any change in policy towards agriculture and foreign exchange restrictions could affect Okomu's earning potential. A policy reversal on the ban of oil palm from accessing foreign exchange on the official market will prove to be quite detrimental to the competitiveness of Okomu as it will hurt its market share and earnings.

Shocks in the global commodity market are a major threat to Okomu. The anticipated glut in global supply will lead to a plunge in global market price thereby encouraging importation. This in turn will dampen the company's earnings despite the foreign exchange restriction on imported oil palm.

Our valuation

Our valuation

Using the Discounted Cash Flow (DCF) methodology, we estimated a stock price of N75.43, which is a 0.42% downside on the current price of N75.75 as of November 14, 2018. The discount rate (Weighted Average Cost of Capital (WACC)) of 17.9% was derived using a 15% risk free rate (FGN 5-year Bond as at September 2018), a Beta of 0.519, an after-tax cost of debt of 9.4%, and a market risk premium of 6.34%. The long-term cash flow growth rate to perpetuity calculated is 8.5%.

Based on our analysis above, we place a **HOLD** rating on the stock.

DCF Valuation			
N'000	**2018E**	**2019E**	**2020E**
EBIT	11,939,643	15,864,860	18,258,851
Less: Taxes	(2,135,274)	(2,837,256)	(3,265,395)
EBIAT	9,804,369	13,027,604	14,993,456
Plus: D&A Expense	(897,323)	(909,743)	(964,837)
Less: CAPEX	(3,158,218)	(4,795,961)	(6,841,951)
Less: Change in working capital	536,065	(1,390,672)	676,777
Free Cash Flow (FCF)	6,284,893	5,931,227	7,863,445
WACC	17.9%	17.9%	17.9%
Present Value (PV) of FCF	5,332,660	4,270,086	4,803,424
	2018	**2019**	**2020**
Terminal value			91,185,027
Present value of terminal value	55,700,817		
DCF Calculation	**Valuation**		
PV of explicit period	14,406,170		
PV of terminal value	55,700,817		
Enterprise Value	70,106,986		
+ Cash	3,093,792		
- Borrowings	(1,251,505)		
Equity Value	71,949,273		
Share price	**75.43**		